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As I see

THE FUTURE MARKET PRICE OF RESIDENCES

SUETONIUS, the private secretary of the Roman emperor Hadrian, some time prior to 135 A. D., in his book The Lives of the Twelve Caesars, wrote of Octavius Augustus, "By bringing the royal treasures to Rome in his Alexandrian triumphs he made ready money so abundant that the rate of interest fell and the value of real estate rose greatly." Apparently in the recent past we have experienced a drop in the interest rate and a rise in real estate values due to the same fundamental causes which brought about these results more than 1800 years ago. The amount of currency and credit in circulation has been increased to three times its 1939 level and to six times its level at the bottom of the depression. It would indeed be surprising if this increase in "money" had not brought about the same result that an increase in gold and silver brought about in ancient Rome.

In my opinion, however, the crest of the real estate boom was reached some time ago. While many properties are still being listed and advertised at peak prices, they are no longer selling at those prices. Our index of real estate activity based on the number of voluntary transfers of real estate in principal cities of the United States reached its high point in May of 1946. It is now 47 per cent below that peak.

We started advising our clients to sell single-family residences last May. Last July we were putting our advice in red type. But what of the future?

Many persons familiar with the rise in our national debt and the resulting increase in the supply of money and credit in circulation believe that further inflation is in store and, of course, there is always some chance that we may be so mistaken in our national policies that further inflation will result. While I have had little confidence in the economic wisdom coming out of Washington, I still think it more probable that we will not increase materially our national debt from here on out, and the increases in local governmental and private debt will not be sufficient to increase by any sizable percentage the large amount of currency and credit now in circulation.

During the period in which our currency and credit in circulation was increasing rapidly the supply of goods available for consumer use was shrinking. This naturally put tremendous pressure on our price structure, with the resulting rapid drop in the purchasing power of money. While I do not anticipate a shrinkage in the currency and credit, I now believe that a large increase will develop during the next few years in the supply of commodities and services available for consumption. The effect of this should be to increase the purchasing power of the dollar and, unless offset by unwise monetary policies, this will be the result.

The decreasing purchasing power of money is not the only reason why real estate has undergone a rapid rise in the period we have just come through. I am listing below some additional reasons which must be taken into consideration in trying to forecast the future of real estate values.

1. Rent control froze rentals in most communities at practically their prewar levels. As incomes rose, the relative cost of renting dwelling space declined. Persons who lived in housing which they considered inadequate attempted to "move up." Stenographers, clerks and factory workers who had lived in furnished rooms were now able to afford apartments. In the earlier period of the war these units were available. In April 1940 the Federal Census showed that seven per cent of all urban housing units were vacant. Additional units were vacated by persons going into service. In November 1945 the United States Census again surveyed the field and reported that the number of dwelling units occupied by only one person had increased by thirty per cent in comparison with 1940. The number of units occupied by two persons had increased by 22 per cent.

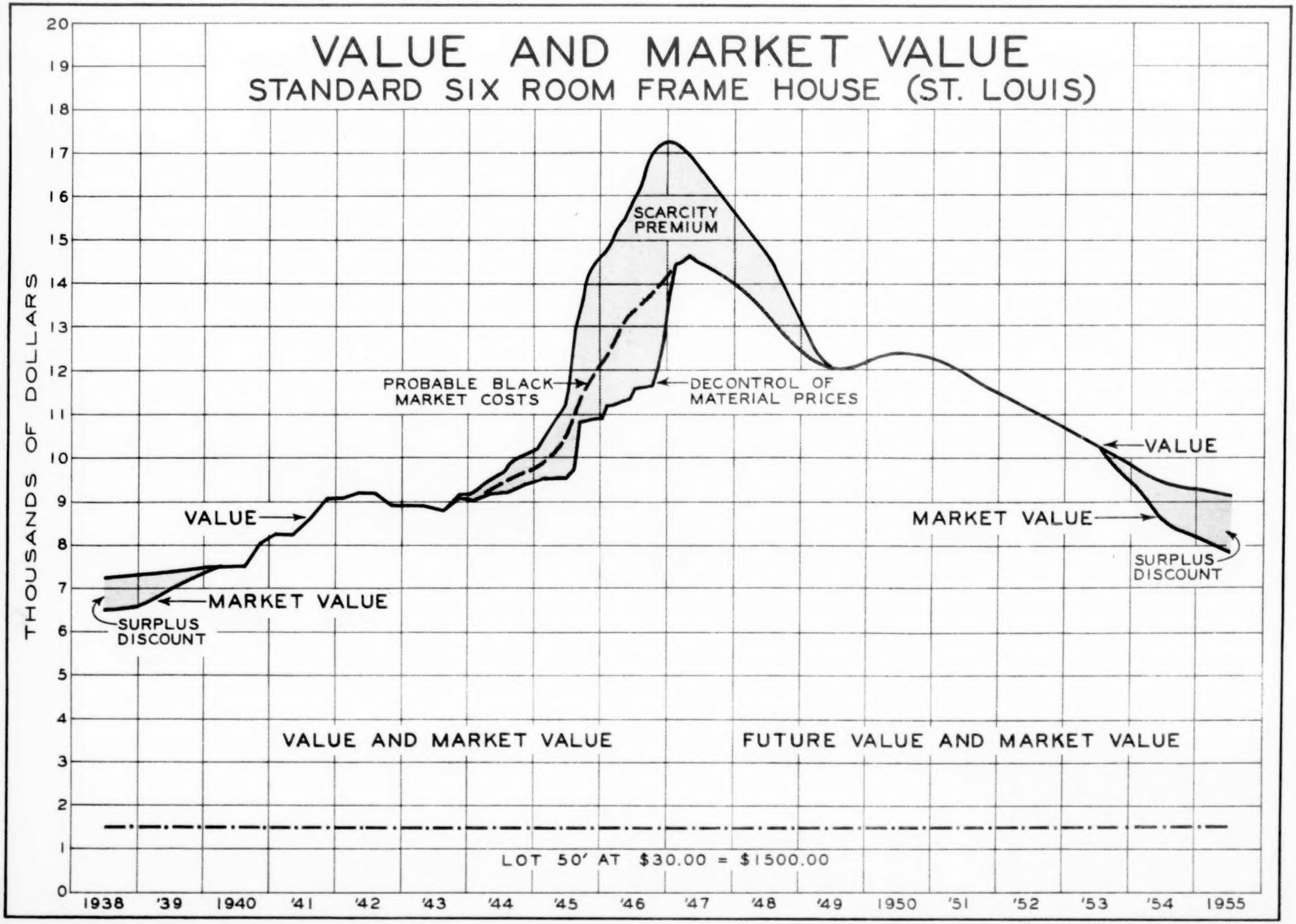
Now this would be fine were there enough dwelling units to go around. But this spreading out by persons with more money to spend, added to by the influx of war workers, brought about the greatest housing shortage on record. Single-family dwelling units, which during the boom of the twenties sold for 100 times the monthly rent, now brought closer to 160 times the monthly rent.

The limitations on building during the war and the clumsy bungling of government regulations in the postwar period made it impossible for building to get started quickly. The demand greatly in excess of supply has given to real estate a scarcity value. People in the last year or so have been willing to pay for shelter far more than the real estate involved was worth in a stabilized market. This premium above value is generally known as scarcity premium. Scarcity premium, however, will continue only so long as the scarcity exists and, should we get back to a balanced market some time in the next few years, scarcity premium will entirely disappear.

2. Largely as a result of inflation, building costs have risen rapidly since the war. Our standard six-room frame house built in St. Louis reached a point 123 per cent higher than its cost when the war started in Europe. Since over a long period the values of all existing buildings are affected by changes in replacement costs this has furnished a strong upward pressure on real estate prices. Unlike the increase caused by scarcity premium, the increase caused by construction costs may remain even after the shortage is over. If costs stay at their present level, the shrinkage in real estate values in the period ahead will be primarily due to the disappearance of scarcity premium. These prices will come to rest at a level very much above the level of 1939.

It is my opinion that construction costs will not remain at their present level but will drop slightly this year, followed by a more rapid drop in 1948. If this occurs, real estate values will drop not only due to the shrinkage in scarcity premium but due also to the drop in replacement costs.

In a number of bulletins I have covered my reasons for thinking that construction costs would drop. It is quite interesting to notice that the cost of our six-room standard frame house has dropped this month by $141. This is the first


VALUE AND MARKET VALUE
STANDARD SIX ROOM FRAME HOUSE (ST. LOUIS)
THOUSANDS OF DOLLARS
SCARCITY PREMIUM
PROBABLE BLACK MARKET COSTS
DECONTROL OF MATERIAL PRICES
VALUE
MARKET VALUE
SURPLUS DISCOUNT
VALUE
MARKET VALUE
SURPLUS DISCOUNT
VALUE AND MARKET VALUE
FUTURE VALUE AND MARKET VALUE
LOT 50' AT $30.00 = $1500.00
0 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20
1938 '39 1940 '41 '42 '43 '44 '45 '46 '47 '48 '49 1950 '51 '52 '53 '54 1955

drop since 1943 and is a decided reversal of trend. It seems to me that further drops will take place this summer and fall, primarily in the cost of material.

I will agree that there is little chance in the next year of a drop in wage scales of site labor. There will be, however, some increase in labor efficiency which will result in lower unit costs. There is considerable unemployment at the present time in the building trades in many large communities, and this unemployment will increase the willingness of labor to cooperate with management.

The chart on page 189 shows what has happened to the value and market value of our house from 1938 to the present. It also shows a "guesstimate" of what the reactions may be between now and 1955. In giving these lines for the future there is no thought on my part that actual developments will follow exactly the lines shown, but I believe that the trends will resemble the ones charted. As this chart is reprinted from time to time, these forecasts will be corrected in accordance with the additional information which becomes available.

There are three things in our forecast which are open to question.

1. We have placed the bottom of the next big depression in 1955. Some economists would place it earlier and some later. Edward R. Dewey, for instance, in his recent book on cycles would seem to indicate the most probable time as 1952 to 1953. Many other persons believe that after a minor readjustment this year and next, four or five good years can be expected before any major drop might occur. 1955, as shown on this chart, represents a compromise between these varying opinions. We will continue to study the various factors which affect this timing and reserve the right to revise our opinions as more information becomes available. I think it highly improbable, however, that the values of single-family residences in any recovery during the next ten years will go above the levels reached in 1946.

2. There is no definite way of estimating how far construction costs may drop in the period ahead. We are assuming that at the bottom of the next big depression (shown on our chart in 1955) the cost of building our house will be at approximately its cost at the top of the real estate boom of the twenties. We do not expect construction costs to drop to their prewar levels. There is some chance that they may not drop by so great a percentage as the drop we show on the chart. The general tendency, however, in thinking of the future is to underestimate the size of readjustments rather than to overestimate it.

3. While undoubtedly the drop in construction costs and in the price of existing buildings will be of great value to the general public needing housing, to those persons who bought at the peak with slim equities this readjustment in price may be calamitous. If the scarcity lasts longer than we anticipate, scarcity premium will drop slower and will give amortized loans a better chance to bring the outstanding balance on the loan down to a point where it will be below market price. If scarcity premium drops rapidly, many loans will get into trouble.

ROY WENZLICK